IS A BALANCE OF TRADE IN FAVOR OF EXPORTS FAVORABLE?

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IMAGINE a country or any geographical area, the inhabitants of which trade freely with the rest of the world, but who in all other respects are sufficient unto themselves. That is to say, we suppose the inhabitants not to travel abroad and outsiders not to travel within, and that none of the resources of the country are owned without and that no outside resources are owned within. It is then evident that the imports of the country must be equal to the exports in point of value, that is, the imports are paid for with the exports. And of the actual international trade of the day we may say: "Other things being equal, any change in imports begets an equal change in exports."

Our inquiry divides itself conveniently into three parts. First we will examine this statement as it stands and see how the mechanism of modern trade tends to maintain a balance between imports and exports. We will then examine the gold question. Is it favorable that a country's imports should contain more gold than her exports? The third part of the discussion will consider those less visible factors in international trade which prevent the equality of imports and exports.

The truth of the statement we are first to examine is apparent on *a priori* grounds—value will be given only for value received. But the intermediate steps in the complicated mechanism of trade that brings it about are not so apparent. How, for example, can a new duty restricting imports into the United States also operate to restrict our exports? Supposing, for simplicity, that we are dealing only with Great Britain. Since we now take less from England, English merchants will have less paper demanding gold on the London exchange. A tendency for gold to flow from England to America is set up by the over-supply there, and manifests itself in the ability of American brokers to secure the metal at a discount. When this discount passes a point just sufficient to cover freight, insurance and interest during transit, gold will be shipped to America. Now the amount of gold for which a thing will exchange is its price—the dollar being by law the exchange value of 23.22 grains of gold. This influx of gold to a country with free gold coinage, and not coming into response to any other demand, will swell the currency and, conversely, prices in general will rise. Assuming that

our supposed curtailment of imports is permanent, gold would continue to flow until prices in general changed, on both sides of the water and in opposite directions. Thus prices will go up in America and down in Great Britain, and English merchants will buy less in America in favor of their own home market. Since their purchases in America are our exports, it follows that our export trade will fall off. Which is what we wished to show.

The change in the prices we have just shown can have no permanent effect upon the internal commerce of either country, for an equal change in the price of everything simultaneously is not a change in exchange values generally.[1] But as between nations, the change is in an opposite direction and very materially affects the international trade. It should be noted that although the change in imports is permanent, the flow of gold induced is not permanent. It is only an initial flow, just sufficient to change the stocks of gold in circulation in the nations in question, to the critical point where changed prices will affect exports in like amount. After that, gold will return to its normal rate of flow.

Of course such a chain of cause and effect could never be illustrated by the actual course of events, for the reason that the "other things" we have imagined equal never are equal. This tendency to a decrease in exports might be entirely neutralized by a counter tendency such, for instance, as a rise in rents of American real estate owned by Englishmen living in England. Economically speaking these rents go to England as commodities, exports, real goods—although the recipient receives not any specific goods so exported, but a draft for gold, which in its turn is merely a draft for so much of any kind of wealth the holder may choose to select from the whole English market. The credit instrument representing the rent due is the effective cause of the flow of just so much real wealth from American shores. International payments are made in goods—real wealth, imports and exports.

This mechanism of trade is purely automatic. It bears the same relation to society that the involuntary functions of the body, such as the circulation of the blood, bear to the individual. Since a country does not transact its foreign commerce in its corporate capacity as a nation, but only as the sum of the transactions of its individuals and commercial houses—a national debit and credit account can not be periodically drawn up to show the total of all transactions. But such an account exists in effect as the sum of the accounts forming its parts. For a single year, or some short period of time, such an account would show an outstanding item or balance representing transactions not yet closed, but this would always be in the act of liquidating itself and would

[1] From 1870 to 1897 there was a gradual fall of about 50 per cent. in prices generally, but by 1910 about half of this had been regained. ("Principles of Economics," H. R. Seager, page 377.)

not accrue with the passage of time. It is not the balance of trade we are here concerned with. In the discussion of the balance of trade as in the discussion of the business of an individual, we are interested in a debit and credit account only to the extent that it shows closed transactions, for only then does it show what is being done as a regular thing, or in the long run. Indeed, the "balance of trade" as a question of "policy" can have significance on no other ground.

It appears from the foregoing that the first effect of checking imports of commodities is to substitute imports of gold, but it has also appeared that the substitution is temporary and is entirely shifted to a permanent checking of exports. This is to say that a nation in its corporate capacity can not force traders to deal in gold—it can not create a demand for gold, and the truth of this will become more apparent as we go on. But our attention must now be turned to the permanent or normal flow of gold. Is a balance of exports regularly liquidated by gold favorable?

This is the gold question. Under the conditions we are supposing, the entire excess of exports would be regularly paid for with an equivalent of gold imported. The "mercantile system" of the eighteenth century regarded the nations as competitors for the world's gold, and each country endeavored to increase its stock of gold indefinitely by attempts to restrict its imports and expand its exports. This idea is now generally abandoned, and among the foremost nations no conscious attempt is now made to attract gold. Indeed, in the case of a country like the United States such an attempt would be without reason, since the United States produces nearly one fourth the world's supply of gold, and is therefore normally a gold-exporting country. Whatever tendency there may be for export balances to become liquidated in gold, it is apparent from the statistics of the foreign trade of the United States that, in our country at least, the persistent balance in favor of exports *is not* paid for in gold. In the last twenty-five years (1890 to 1914 inclusive) the yearly balance for gold has fluctuated between favoring import and favoring export, ten times, while the net balance for the whole period is an insignificant amount (21 millions) favoring gold *export*. For the same period our balance of general trade favoring exports has steadily increased (excepting only the year 1893) to a net amount over *four hundred times* greater than the gold balance (9,358 millions). For any single year the greatest balance favoring a gold import occurred in 1898 when we could truly say that one sixth of our balance of exports, at least, was paid for with gold. But the figures in general are highly incomparable, and the most they show us is that the United States is not the example we are looking for—an example where "other things" are equal. As far as the gold question goes, our thesis remains—is a balance of exports liquidated by gold favorable?

The answer to this question will be in two parts. First, that in so far as the movements in such an exchange are free, obeying the natural law of supply and demand and each commodity moving from a point of lesser value to a point of higher value, the fact of gold being a principle in the exchange can be counted as neither favorable nor unfavorable. Being free bargainers, both parties must benefit in such an exchange or no exchange could take place. The party that sends the gold is better off, as well as the party who gets the gold. Thus a free and healthy exportation of gold would result in a country from such causes as an extensive gold-mining industry, an inflation of the currency with an increasing use of credit money, or from a decreasing demand for jewelry. This free or natural movement of gold, then, forms no part of the "balance of trade" discussions for gold so moving simply takes a place along with all other commodities forming the international trade.

The second part of our answer refers to a movement of gold that is not free, that is to a movement consciously instigated by a nation acting through its government. It was such a movement the "mercantilists" believed the successful nations succeeded in bringing about, draining gold from the less successful nations to themselves, in spite of the strong tendency to a counter flow which such an unequal distribution of gold would induce. They believed such a nation was thrifty in that it was saving wealth in the form of stored gold, to be reexchanged in time of war or stress, for useful commodities from other countries. This idea was probably a survival from times when interest-earning capital wealth was little known.

It is necessary to keep clearly in mind that we are not now discussing the free or natural movement of gold. Gold acquired with intention to save is not for use in coinage or any other way, for that comes through a natural demand. Gold stored in vaults serves no present use, but only the potential use contingent upon war.[2] It is capital wealth out of use —not drawing interest. For a nation to store wealth in this way it must buy gold with its commodities from other nations, paying an ever increasing premium as the foreign supply diminishes. Whatever the enactment which brings this about, it is in essence a tax upon the coun-

[2] The mind of the reader may here revert to the gold stored in the United States Treasury as security for paper money in circulation. The money problem properly forms no part of our subject, but for the sake of keeping proper proportions in the mind it may be well to state what this store of gold is. According to the report of the Secretary of the Treasury, there were one thousand eight hundred and fifty-eight million dollars in circulation and in the treasury, in the form of gold coin and bars, on April 1, 1913. Fifty-eight per cent. of this was security for gold certificates in circulation. If our balance of exports for the last twenty-five years had been paid for in gold, the amount would have been sufficient to increase this government stock sixfold, making it about eighty per cent. of the world's stock of gold.

try's own people who furnish the commodities with which to pay. In a sense they are paying interest on a debt before it is incurred—the debt of war. The people are saving only in the sense in which a miser saves, only because they have a certain soreness and fear towards other peoples. It is a superstitious regard for gold that no longer exists. A nation that hoards gold is making a sacrifice for something in which other nations are not trying to forestall her. To-day the process of saving is a creation of working capital goods, of wealth such as buildings, railways, machinery and so on. And in time of war such working wealth is quite as negotiable as gold; for a country at war may not only sell her securities for the necessaries she may immediately need, but so stable has the commercial world become she may undertake a public debt by issuing bonds for sale to other nations. The hoarding of gold is bad then, because working capital is better than idle capital, even in time of stress. Since this is now generally recognized, the point in favor of hoarding can not be granted even as a concession to "relative ethics." The nations of to-day are hardly more keepers of gold than are our rich men.

Therefore we say: A balance of exports induced for the purpose of storing gold for time of stress is unfavorable. Indeed, it seems to be doubtful if in these times such a balance could exist, but that in general it does not exist is sufficient warrant for the elimination of the gold question from the trade controversy by merging gold along with other commodities making up exports and imports. Gold moves first only because it has the least bulk and weight for a given value, but this gives it no distinction in kind over pig iron or any other form of wealth. The discussion is now reduced to that net balance of trade remaining after gold has been accounted for by including it in the inventory along with all other commodities.

Having satisfied ourselves that international payments are made in goods, exports and imports, of which gold is only one out of several hundreds, we have cleared the ground for the third part of our discussion, for an examination of the causes that make a "balance of trade" possible.

An international debit and credit account is not complete until every transaction affecting the transfer of wealth has entered into it. On broad lines such transactions might be divided into four classes, which would include them all. These are: exchanges, gratuities, loans and interest. Wealth may pass between two parties through free exchange, free giving, free lending or giving through coercion. The term interest is made broad enough to include everything from interest strictly speaking to tribute pure and simple. If we expand this to embrace in a more concrete way the larger items of present-day trade, we are able to frame up a general debit and credit account of one country with the rest of the world which is typified by:

ACCOUNT OF THE UNITED STATES WITH FOREIGN COUNTRIES

Debit	*Credit*
1. Imports (including gold).	1. Exports (including gold).
2. Interests on American securities and loans held by foreigners.	2. Interest on foreign securities and loans held by Americans.
3. Purchase of foreign securities, and loans to foreigners, by Americans.	3. Purchase of American securities and loans to Americans by foreigners.
4. Expense of Americans traveling abroad.	4. Expense of foreigners traveling in America.
5. Use of foreign vessels.	6. Remittances to immigrants by friends left at home.
6. Remittances by immigrants to friends left at home.	

A "favorable balance of trade" is considered to be a balance in favor of exports, an excess of exports over imports. Contrary to the general opinion, we propose now to show that such a balance is in reality not favorable.

Since the debit side of our international account from the point of view of the United States must always be substantially equal to the credit side, an excess of exports over imports implies an excess of items 2 to 66 on the debit side over times 2 to 6 on the credit side. That is to say, it implies an excess of one, any or all of them. Let us consider these in turn in the order given.

In so far as an excess of exports means that Americans are paying interest, dividends, rent, etc., to foreigners who own our resources and equipment, it is certainly unfavorable. This is tribute for which our foreign landlords return absolutely nothing. His draft is a draft upon our exports—economically he is paid with our exports. Many Englishmen own large farming tracts in America and these they divide up and let out to tenant farmers who render a very large part of the crop in rent. The owners for the most part remain in England, and thus there is a large export from America for which there is no return. The tribute exacted by Germany of France in 1871 caused a large excess of French exports over her imports. When Rome was mistress of the world, the wealth of the provinces was drained to her by taxes, tribute and rent for which no return was made. Her trade weighed heavily on the side of imports, yet it was a most "favorable" trade for her. We are cheerfully told that the picturesque Russian provinces in the Caucasus flourish under an export trade five times larger than the import. What does it mean? Probably that the greater part of the district is owned by Russian noblemen living in St. Petersburg, whose rents reach them through this heavy export trade. So in India, the "home charges" of an alien government and the remittances of alien officials cause a permanent excess of exports over imports.

In regard to item 3 let us suppose that Americans were to regularly

invest the same amount in foreign securities each year. At the end of the twentieth year, interest on twenty such annual investments would be due, and if the rate of interest was five per cent. or 1/20, the return to our country in interest would just balance the yearly purchase of securities. That is to say, item 2 on the credit side would just offset item 3 on the debit side. Or if this interest was compounded or more than compounded by an ever increasing annual investment by Americans, the annual purchase of foreign securities might indefinitely exceed the interest returns on them. But it is not only inconceivable that the annual investment should continually increase, it is inconceivable that it should remain constant. It is quite possible that any of these things might occur for one year or for a number of years, to be offset in other years by reverse flows, but that in the long run, or as a continuous process, our investments should regularly exceed the returns from them is impossible. The process of investing is a process of saving or creation of capital goods, and it is well understood that the amount of capital goods the world can use is limited. With the progress of invention this amount would increase and might increase rapidly, but could not increase indefinitely. Static periods and periods of decline must alternate with these rises, in which the capital in existence is sufficient and there is no saving at all. Mankind generally must forever produce and consume as a continuous process, but mankind generally can not save as a continuous process. The moment a certain limited and sufficient capital stock is brought into existence, saving must cease, for there is no gainsaying the principle that men seek to satisfy their wants with a minimum of effort. If mankind does not consume what can not be invested, then his wants can be satisfied with both less labor and less capital.

We conclude then that our annual purchase of foreign securities can not regularly exceed the interest returns from them, for if such were the case it would mean that Americans were gradually and surely acquiring the resources of the rest of the world at the same time they were receiving no net return.

Statistics showing the country's status in regard to items 2 and 3 are difficult to obtain. In *The Review of Reviews* (April, 1915) is a pertinent discussion of the billion-dollar export balance augured for 1915, and its relation to these "invisible factors" of international trade. We will quote from this in part, and in reading it the fact that our export balance has hovered around the half-billion mark for the last four years should be borne in mind. For the four years ending with 1914 the balance was 522, 551, 652 and 470 millions, respectively, so we may fairly say the normal excess is roughly half a billion dollars, and that the billion-dollar excess for 1915 is an abnormal excess induced

by the sudden call of Europe for war material. On page 403 of the review we read:

> . . . Sir George Paish has estimated that the item of freight and insurance charges is probably not more than $25,000,000. Competent statisticians have put our annual net return on indebtedness abroad at $300,000,000,—from which a deduction of $50,000,000 should be made for returns on American capital employed in foreign countries. Adding to these offsetting items the remittances to relatives and friends of the laborers, the statisticians figure that from the face figure of our favorable balance there should be deducted perhaps $500,000,000. On this basis we should for 1915 have a final net balance in our favor of more than half a billion dollars.
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> How Will Europe Settle With Us?
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> This does not however allow for the returns from foreigners of our securities which they have held and now sell back to us. The total of our securities held abroad is generally estimated to be about $6,000,000,000. It is certain that during the last few months a considerable fraction of this great total of bonds and stocks has been sold back to Americans, although the situation is too complicated to determine just how much. But at any rate it is difficult to see how Europe will settle her growing balance of indebtedness to America in any other way than by returning yet more of these securities. The summary way of settling the current debt would be by sending gold to New York, but in the first place the countries at war will not give it up, and in the second place it would not be desirable from our own point of view, as we have a plethora of gold at present.

It may fairly be inferred that the figures representing securities and returns therefrom are for normal conditions just before the war. It is most instructive to note that the statisticians show a substantial balance of the international debit and credit account for the normal years. They say about 500 millions should be deducted from the face figure of our favorable balance, and this lacks only one tenth of the average balance of trade for the four normal years. About one half of this they account for through our item 2, and for the rest items 5 and 6 are mentioned, although we suspect that item 4 for normal years was also included.

So much for what the figures show us as to normal or "running" conditions. That half of the billion-dollar balance not accounted for at the end of 1915 is the temporary balance which will be, must be, wiped out when we are able to average up the account with a few of the years yet to come. The transactions of 1915 are especially incomplete. But we can not insist too strongly that this temporary balance is not the so-called "balance of trade." The one is a balance about to be settled, the other is a running balance that will never be settled. Such a temporary balance can be counted as neither favorable nor unfavorable, for if the fact of having something due us is favorable, the payment of the due is a cancellation of the favor. No one will contend that it is favorable to a creditor that the debts he holds should never be

settled, yet only by such a system could his credit balance attain a maximum.

"How will Europe settle with us?" If we examine the debit side of our international account it appears that item 3 furnishes her only means in this time of her stress. Being too busy with war to make commodities for us, she must sell us her securities or sell us back our own securities or negotiate a loan from us. Each of these methods is at base a loan and on each Europe would have to pay interest.

Let us suppose that Europe has settled this half billion temporary balance by the transfer to us of the ownership of securities to that amount. And further let us suppose that after the war we are content to retain those securities and that Europe is unable to rebuy them. What permanent change has the war made in our trade balance and in whose favor is it? Clearly we shall be paying less interest and Europe more, to do which we must send her less goods and she send us more. Our balance of exports will be reduced or turned into an import balance and the movement will be in our favor. The heavy dealings in item 3 having ceased with the settlement of the abnormal temporary balance of trade, the large running balance in item 2 on the credit side will be offset by a large running balance in item 1 on the debit side. Europe can not forever settle this running debt of interest by continually incurring more debt or selling securities. If she is not to totally impoverish herself, she will sooner or later have to settle by swelling our imports with the tangible results of her labor.

An excess of exports may mean that there is much American travel abroad. Some say that it is a drain upon the United States for Americans to take their vacations abroad, because it gives the hotel business to Europeans instead of Americans. If this were true it would of course be an argument against the "favorable balance of trade" idea. As a matter of fact the travel abroad is neither a drain nor a benefit. If it gives hotel business to Europeans, it also gives an equal business to manufacturers of exports in the United States. What the travelers get in Europe is paid for with exports from the United States. Or we may look upon it in this way. In serving travelers, Europeans are taken out of other fields of production in which they would otherwise have produced for their own consumption. Their own consumption is now satisfied by producers in America, who export to the European market more than they otherwise would export, to just the extent of the drafts on America presented by our travelers at the European exchanges. Or, prospective American travelers produce wealth in America which they save, and consume later in Europe. What they nominally take with them is a letter of credit, but what they take economically is a certain quantity of exports which the letter of credit or other instrument releases from the American shores.

An excess of exports may mean that most of the ocean carriage is done in foreign bottoms, the excess being freight for carriage. Here again we see that if the business of carrying is taken away from us, an equal business of manufacturing the exports with which to pay the carriage is given to us. Any argument favoring the building up of our merchant marine is against the "favorable balance of trade" idea.

Items 4 and 5, then, do not seriously enter into the argument of the balance of trade, because it is easy to see that value is given for value received. They are the only cases of an export balance that is not unfavorable. But, be it observed, neither is their balance favorable.

Unlike the last two items we have discussed, remittances to friends are gifts for which there is no return. In so far as an excess of exports means that people in America are sending gratuities to Europeans, it is an economic drain upon America.

Our answer, then, to the question which has been the subject of this discussion—is a balance of trade in favor of exports favorable?—is an unqualified negative. We have seen that the export balance induced by travel abroad and the use of foreign bottoms is neither favorable nor unfavorable, and that the balance induced by the joint action of all other causes is unfavorable. Foremost among these other causes is the joint action of items 2 and 3 in which we have seen that item 2 must predominate. We have seen that the "gold question" might be used to support our negative did it have existence in fact, but we have also seen that in modern times its existence in fact is negligible. The parts of the problem which outweigh all others in considering the economies of a modern nation like the United States are to be seen in a survey of items 1 and 2. If we include the terms interest, dividends, rent, profits, under the single term interest, then we may say that an excess of exports means that a country pays more interest than it receives, that it is giving without receiving, that its resources are owned abroad when they might be owned at home.

Our conclusion is directly contrary to the current notion. So widespread and ingrained is the idea that an export balance constitutes a gaining trade, it is not sufficient for us to disprove it—we must account for it.

Our ideas regarding the actions of states and nations usually find their counterpart in our ideas regarding individuals. Probably the idea that it is more profitable to export than to import receives currency through the idea that it is profitable for a man's sales to exceed his purchases. This idea is a true one only when we have in mind a part of his life, his business life—only when we exclude from the term purchases, his purchases for consumption. We usually reckon profit or income upon money or credit outstanding, but this is a potential profit

which does not materialize until converted into goods or services for consumption. Now money or credit is merely a sign of uncompleted exchange, and a man's exchanges are not complete save to the extent that he has spent outstanding money or credit for goods or services for consumption. What we really have in mind when we say selling is better than buying is that a large excess of a man's sales over his purchases of capital goods is profitable *because* it is followed by a large purchase of consumable goods. Dealings in capital goods are profitable only *because* of this. The fallacy in transferring the idea to international trade lies in slurring over just this usually unexpressed qualification. With the man we are thinking of his uncompleted exchanges, while with the nation the "balance of trade" is an item in a balanced account of completed exchanges, and to that extent it is not a balance at all. With the man, his excess of sales is a credit, a lien upon the market, while with the nation her excess of exports is not a credit. That the trade balance is not a credit appears in startling form when we begin to look about for tangible evidence of credit. No one is puerile enough to believe that the nine-billion-dollar export balance of the United States, accrued during twenty-five years, is a lien to that extent upon the wealth of other nations and that either American citizens or the American government hold mysterious papers that have the power to recall nine billions of foreign wealth to our shores when we shall choose to have it. And if any doubts remain as to a certain store of gold, it is only necessary to remember that that nine billions is over and above all exports paid for with gold.

The current idea in regard to the balance of trade is closely associated with the doctrine of protection and the popularity of that doctrine is doubtless another source of the support the trade-balance idea receives. Those who believe in the protective tariff will believe in the "favorable balance of exports." In this connection its fallacies are obscured by the ease with which people are impressed with the concrete good or evil of an individual or small group of individuals, and the difficulty with which people are impressed with the general good or evil diffused over the whole community. It is doubtless true that protection and restricted imports are favorable to *some* Americans, but it can only be so at the expense of all other Americans, for we have seen that it is not favorable to the community as a whole.

But the question of the balance of trade here stands clear cut and apart from the tariff controversy, of which it forms an independent part. In the light of our demonstration it may fairly be said that of all popular fallacies it would be difficult to find another so groundless, so contrary to our simplest intuitions, and so readily capable of disproof, as the notion that it is more profitable to send things away than to take them in.